No. 9413

In the United States Circuit Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES LAUGHTON, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE PETITIONER

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CITATIONS

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 21–33) is reported in 40 B. T. A. 101.

JURISDICTION

This appeal involves income taxes for the years 1934 and 1935, and is taken from the decision of the Board of Tax Appeals entered September 11, 1939 (R. 33–34). The case is brought to this Court on a petition for review filed November 28, 1939 (R. 35–42), pursuant to the provisions of Sections 1141–1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether amounts paid by motion picture producers to taxpayer's wholly owned corporation, to which he

had sold his exclusive services, constitute taxable income to the taxpayer.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 23–24.

STATEMENT

The relevant facts, as found by the Board of Tax Appeals, are as follows (R. 22–29):

The taxpayer, Charles Laughton, is a motion picture actor well known in both Great Britain and the United States. At all times pertinent to this proceeding he was a subject of Great Britain and a resident of and domiciled in England. (R. 22–23.)

On May 4, 1932, the taxpayer executed a five-year contract with Frank Joyce-Myron Selznick, Ltd., which authorized them to act as his manager and personal representative. During 1932, the taxpayer came to the United States and was engaged in making four pictures for the Paramount-Publix Corporation, predecessor of Paramount Productions, Inc. He also made one picture for the Universal Pictures Corporation during 1932 under a loan of his services by Paramount-Publix to Universal. (R. 23.)

On March 29, 1933, the taxpayer entered into a contract with Paramount Productions, Inc., hereinafter referred to as Paramount, under the terms of which one picture, "White Woman," was produced in that year. Paragraph Twelfth of said contract provided in part as follows (R. 23):

> The Artist hereby grants to the Corporation an option upon the Artist's exclusive services in

> one (1) motion picture photoplay to be produced between April 15, 1934, and September 15, 1934, at the salary and at the rate of Three Thousand ($3,000.00) Dollars per week for not less than five (5) weeks for his services in such production.

Under date of September 15, 1933, Paramount notified the taxpayer that it elected to exercise the foregoing option. (R. 23.)

After completing the picture, "White Woman", the taxpayer returned to England, and on April 30, 1934, a corporation bearing the name of "Motion Picture and Theatrical Industries, Limited," hereinafter referred to as Industries, Ltd., was organized under and by virtue of the laws of Great Britain, and specifically under the English Companies' Act of 1929. As set forth in its memorandum of association, the objects for which the company was established were to engage in the motion picture and theatrical businesses or any business incidental or related thereto. (R. 24.)

The principal place of business of Industries, Ltd., has been at all times since its formation and now is London, England. During the taxable years it was managed by a board of directors composed of businessmen. The taxpayer was not a member of the board of directors, nor was he an officer of the company, although he was the real beneficial owner of all its outstanding stock, except qualifying shares, for which he paid into the company £6,000 or approximately $30,000. (R. 24.)

On May 4, 1934, taxpayer and Industries, Ltd., executed a contract in London, whereby, in return for the payment of £150 or approximately $750 per week for the next five years thereafter, together with the pay-

ment of certain other expenses, taxpayer agreed to give his sole and exclusive services to Industries, Ltd., subject always to the primary obligations of a contract entered into February 26, 1934, and then existing between taxpayer and London Film Productions, Ltd., whereby taxpayer was to make three pictures for the latter company. The taxpayer agreed to assign the profits and any moneys arising from the latter agreement and his right to 10 percent of the gross receipts from the photoplay "The Private Life of Henry VIII" to Industries, Ltd., as part of the consideration for the contract of May 4, 1934. Industries, Ltd., agreed to assume the obligations of the taxpayer under his contract of May 4, 1932, with Frank Joyce-Myron Selznick, Ltd. Paragraph 15 of taxpayer's agreement with Industries, Ltd., provided as follows (R. 25):

> Nothing in this Agreement shall be contrary to the proposition that from time to time it is contemplated that the Employer itself will be engaging in motion picture or theatrical activities in the British Isles in connection with which it shall employ the Employee and in no case will it engage in any motion picture or theatrical activities in which there shall be a male principal part without employing the Employee in the enactment thereof unless the Employee expressly and in writing shall assent to the Employer in any such activities employing some other actor.

On May 5, 1934, taxpayer sailed for the United States. On May 14 he reached Los Angeles and immediately commenced work as an actor in "The Barretts of Wimpole Street" for Metro-Goldwyn-Mayer under

a pending loan agreement which was finally executed between Metro-Goldwyn-Mayer and Industries, Ltd., on July 6, 1934. The agreement became effective as of May 14, 1934, provided for taxpayer's appearance in "The Barretts of Wimpole Street" and "Marie Antoinette", and permitted him to appear in one photoplay for Paramount. Metro-Goldwyn-Mayer paid Industries, Ltd., for the services performed by the taxpayer under the loan agreement $45,333.33 during 1934 and $119,230.76 during 1935. (R. 25–26.)

On July 5, 1934, the contract of March 29, 1933, between taxpayer and Paramount was canceled by mutual consent, and on the same day Industries, Ltd., entered into an agreement with Paramount relative to the services of the taxpayer. This contract and the contract of Industries, Ltd., with Metro-Goldwyn-Mayer were both acknowledged by taxpayer in a separate writing, attached to each contract, wherein he obligated himself, individually, to render the services agreed upon by the studios and Industries, Ltd. Subsequent contracts and modifications of existing contracts for the loan of Laughton's services by Industries, Ltd., were likewise acknowledged by the taxpayer. (R. 26.)

Under the loan agreement with Paramount taxpayer performed in "Ruggles of Red Gap", and Paramount paid Industries, Ltd., for such services the sums of $48,000 in 1934 and $6,000 in 1935. (R. 26.)

On December 21, 1934, Industries, Ltd., contracted for the loan of Laughton's services to Twentieth Century Pictures, Inc. During 1935 Industries, Ltd., received $65,000 from Twentieth Century Pictures, Inc.,

for the services rendered the latter company by taxpayer. (R. 27.)

Each of the three studios aforementioned deducted and withheld from the amounts that were to be paid to Industries, Ltd., the sums prescribed as income tax to be withheld at the source under the provisions of Section 144 of the Revenue Act of 1934. The sums so deducted were paid over to the Collector of Internal Revenue by the studios in the amounts and for the years as follows (R. 27):

	1934	1935
Metro-Goldwyn-Mayer	$6,233.33	$16,394.24
Paramount Productions, Inc	6,600.00	825.00
Twentieth Century Pictures, Inc	---------	8,937.50
Total	12,833.33	26,156.74

Industries, Ltd., filed its federal corporation income and excess profits tax returns for 1934 and 1935 showing net income of $46,255.60 and $143,618.53 for 1934 and 1935, respectively. As to each year the return shows that the income tax due was less than the amount withheld by the studios; the overpayment shown on each return amounted to $6,473.18 for 1934 and $6,409.19 for 1935. (R. 27.)

Industries, Ltd., filed capital stock tax returns for the fiscal years ended June 30, 1934, 1935, and 1936, and claimed exemption from payment of the capital stock tax. After the claimed exemption was denied, Industries, Ltd., paid a capital stock tax for each of the years. (R. 27–28.)

The taxpayer reported the salary he received from Industries, Ltd., for the taxable years 1934 and 1935, amounting to $32,811.66 and $22,419.09, respectively, and paid the income tax due thereon to the Federal

Government, and paid an income tax to the State of California for the year 1935. (R. 28.)

Industries, Ltd., filed claims for refund for the amount of tax withheld by the studios over and above the amounts shown as due on its income tax returns for 1934 and 1935. Additional claims for refund were filed by Industries, Ltd., for the refund of all the corporation's income tax withheld from it and paid to the Collector by the studios in order to protect the corporation's interest in the event that this proceeding should result in the taxation of income to taxpayer. Claims for refund were also filed for the capital stock tax paid for the fiscal years. Subsequent to the taxable years and in 1937 the Bureau of Internal Revenue denied the claims for refund as to capital stock tax. (R. 28.)

During the first year of its existence, May 1, 1934, to April 30, 1935, Industries, Ltd., loaned taxpayer $22,520 and during the second year it made additional loans to the taxpayer amounting to $78,625. The loans in the first year were made because of the extra expense to the taxpayer of maintaining living quarters in Hollywood and London simultaneously. The loans made in the second year were nearly all spent in the purchase of a leasehold in London and a valuable painting. These loans were amply secured by the assignment of life insurance policies amounting to $100,000 and by the leasehold. (R. 28–29.)

Industries, Ltd., was organized for a business purpose. During the taxable years the company began gathering material and preparing for future production. In December, 1935, it acquired an option on a

play called "The First Gentleman". It did not begin production of pictures in the taxable years, on account of lack of funds. Subsequent to the taxable years and after the company had accumulated sufficient capital it actively engaged in production either on its own account or through a subsidiary company. (R. 29.)

STATEMENT OF POINTS TO BE URGED

The United States Board of Tax Appeals erred:

1. In holding that there are deficiencies in income tax for the years 1934 and 1935 in the respective amounts of only $289.66 and $264.22.

2. In failing to hold that there are deficiencies in income tax for the years 1934 and 1935 in the respective amounts of $23,160.03 and $81,270.24.

3. In holding that the corporate entity of Industries, Ltd., must be recognized.

4. In holding that the amounts paid by Metro-Goldwyn-Mayer Corporation, Paramount Productions, Inc., and Twentieth Century Pictures, Inc., for taxpayer's services, to Industries, Ltd., did not constitute taxable income to taxpayer.

5. In failing to hold that on the facts an exceptional situation is here presented where the recognition of the corporate entity of Industries, Ltd., presents an obstacle to the due protection and enforcement of public rights.

6. In failing to hold that the arrangement between the taxpayer, Industries, Ltd., and Metro-Goldwyn-Mayer Corporation, Paramount Productions, Inc., and Twentieth Century Pictures, Inc., was an anticipatory arrangement designed to prevent the amounts paid

for taxpayer's services from vesting immediately in taxpayer.

7. In failing to hold that the purpose of Congress to tax payments for services to the party performing such services cannot be frustrated by such anticipatory arrangement whether it be designated a transfer of future income or future services.

8. In failing to hold that the personal earnings of the taxpayer are taxable in their entirety to him.

9. In failing to hold that the amounts paid by Metro-Goldwyn-Mayer Corporation, Paramount Productions, Inc., and Twentieth Century Pictures, Inc., for taxpayer's services represented compensation for personal service taxable to him.

10. In holding that Industries, Ltd., was formed for a business purpose.

11. In failing to hold that Industries, Ltd., did not serve a business purpose in connection with the income received during the taxable years in question.

SUMMARY OF ARGUMENT

The income in question was paid solely for, and earned exclusively by, the personal services of the taxpayer, although not received by him. The fact that the compensation for taxpayer's services was paid, pursuant to contractual arrangements, directly to Industries, Ltd., does not relieve taxpayer of the liability to pay income taxes on what he earned, for it is firmly established that income is taxable to him who earned it, notwithstanding any anticipatory arrangements which may prevent it from vesting even for a moment in the person who earned it.

The resort to the corporate entity as receptacle for the income earned by taxpayer, and which would otherwise admittedly be taxable to him, does not afford an immunity from taxation. Taxpayer, through his wholly owned corporation, retained control and all beneficial interest in the money paid by the producers for his services. What they paid, he in reality received, and on that he must be taxed. This result is in no way altered by the finding that Industries, Ltd., was organized for a business purpose, for it is clear that it performed no business functions whatever in connection with the production of the income in question.

ARGUMENT

The amounts paid to his wholly owned corporation, solely for his personal services, constitute taxable income to the taxpayer

On April 30, 1934, taxpayer, who was a subject of Great Britain, resident and domiciled in England, caused to be organized a wholly owned corporation[1] bearing the name of "Motion Picture and Theatrical Industries, Limited", hereinafter called Industries, Ltd., under the laws of Great Britain. (R. 23, 24.) At that time, taxpayer was already well known as a motion picture actor in the United States. During the year 1932, the taxpayer made five pictures for American film producers in the United States, and on March 29, 1933, he entered into a contract with Paramount Productions, Inc., hereinafter called Paramount, whereby

[1] The Board found, and it is not disputed, that taxpayer was the real beneficial owner of all of the outstanding stock, except qualifying shares. (R. 24.)

he was employed to make two pictures (of which only one was produced) at a salary of $2,500 per week for not less than five weeks for the first production and $2,750 per week for not less than five weeks for the second production. (R. 23, 96.) This contract also granted to Paramount an option on taxpayer's services for the production of one picture in 1934 at a salary of $3,000 per week for not less than five weeks, and on September 15, 1933, Paramount notified taxpayer that it elected to exercise that option. (R. 23.)

Thus, on April 30, 1934, when taxpayer organized Industries, Ltd., he was confronted with the virtually certain prospect of very large earnings from his services as a motion picture actor in the United States, and actually had a contract with Paramount for one picture during that year under which he was to receive $3,000 per week. Nevertheless, on May 4, 1934, taxpayer entered into a contract with his wholly owned corporation whereby he gave it the right to his sole and exclusive services for a period of five years for only £150 or approximately $750 per week. (R. 24.)[2] On the day after execution of the contract with Industries, Ltd., whereby taxpayer was to receive only $750 per week, he sailed for the United States, and *immediately* went to work for Metro-Goldwyn-Mayer under a pending loan agreement, executed shortly thereafter, between Metro-Gold-

[2] This agreement was subject to a prior contract whereby taxpayer was to make three pictures for London Film Productions, Ltd., but taxpayer agreed to assign to Industries, Ltd., any profits and other moneys arising from the contract with London Films, and also his right to 10% of the gross receipts from the picture "The Private Life of Henry VIII", as part consideration for the contract of May 4, 1934. (R. 24–25.)

wyn-Mayer and Industries, Ltd., under which Industries, Ltd., received from Metro-Goldwyn-Mayer $45,333.33 during 1934, and $119,230.76 during 1935. (R. 25–26.) On July 5, 1934, the contract of March 29, 1933, between taxpayer and Paramount, under which Paramount had exercised its option to employ taxpayer at $3,000 per week for one picture during 1934, was cancelled by mutual consent and on the same day Paramount and Industries, Ltd., entered into an agreement for taxpayer's services, pursuant to which Industries, Ltd., received $48,000 in 1934 and $6,000 in 1935. On December 21, 1934, Industries, Ltd., and Twentieth Century Pictures entered into a contract for taxpayer's services, under which Industries, Ltd., received $65,000 in 1935. (R. 26–27.) All contracts between Industries, Ltd., and the motion picture producers were "acknowledged" by the taxpayer in a separate writing, attached to each contract, wherein he obligated himself personally to render the services agreed upon between Industries, Ltd., and the producers. (R. 26.)

In short, during the two taxable years, 1934 and 1935, Industries, Ltd., received, solely for the loan of taxpayer's services, which he had personally guaranteed to perform, the aggregate sum of $283,564.09. In significant contrast, under its contract with taxpayer, executed on May 4, 1934, very shortly before such services were begun, at which time the amounts to be realized from such services could reasonably be anticipated, Industries, Ltd., paid to the taxpayer only $32,811.66 and $22,419.09 for the years 1934 and 1935, respectively. (R. 28.) It is apparent from these facts that the con-

tract between taxpayer and Industries, Ltd., was merely a conduit for the transmission to England of taxpayer's earnings from his personal services in the United States, without paying more than a small portion of the taxes which would admittedly be due had taxpayer's earnings been paid directly to him. We submit that taxpayer's arrangements for the transmission of the fruits of his personal services to his corporate *alter ego* should be ignored, and that he should be taxed on what he earned.

It is true that taxpayer did not personally receive the sums paid for his services. By virtue of the contract of May 4, 1934, whereby he sold his services to his wholly owned corporation for an amount patently inadequate in the light of what those services could assuredly command from American producers, the money was paid directly to Industries, Ltd. But that circumstance does not afford an immunity from taxation. The vital and inescapable fact, which may not be obscured by the contractual arrangements between taxpayer, Industries, Ltd., and the producers, is that the income in question indubitably arose solely from the personal services of the taxpayer, as is conclusively shown by the requirement of all the producers that taxpayer personally guarantee the performance of the services for which Industries, Ltd., had contracted. The principle is well established that payments for personal services are taxable to the one who earned them, despite any "anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it." *Lucas* v. *Earl*, 281 U. S. 111, 115.

A close parallel exists between the situation in the instant case and that which obtained in *Jones* v. *Page,* 102 F. (2d) 144 (C. C. A. 5th), certiorari denied, October 9, 1939. In the *Jones* case, the taxpayer, a famous golfer, had entered into a contract with a motion picture producer to make a series of pictures depicting his form and style in playing golf. The contract provided that he should receive compensation in the sum of $120,000, plus 50 per cent of the net receipts from the distribution and sale of the pictures. Of this sum, $20,000 was paid to him in advance. After that, but before he began making the pictures, taxpayer entered into a contract selling his services to his father for a term of six years at $1,000 per year, and transferred to his father his rights under the existing contract with the motion picture producer. The father then transferred his rights under the contract to himself in trust for taxpayer's minor children. Before the production of the pictures was commenced, the original contract between the taxpayer and the producer was cancelled by mutual consent, and a new contract, substantially identical, was made between taxpayer's father, as trustee, and the producer. Taxpayer himself guaranteed that he would perform the services for which his father had contracted. The services were then duly performed by taxpayer, and payment was made by the producer to the father as trustee. In holding that the amounts so paid for taxpayer's services were taxable to him the court declared (p. 145):

> In conceding that a taxpayer has the right to decrease the amount of his taxes or to avoid them by legal means, in every instance where that is

> attempted, a court may look through the transaction and determine whether it is legal or violates the intent of the statute. It would be absurd to say that any reasonable man having a contract from which he was to receive a minimum of $100,000 would in good faith transfer it to another for merely $6,000. Appellant could have set up the trust in favor of his children without the intervention of his father. The conclusion is inescapable that he used his father simply as a conduit in an attempt to reduce or avoid taxes that would be otherwise assessable against compensation derived from his own personal services. The plan adopted was without legal effect and the taxes complained of were properly assessed against appellant under the provisions of Sections 11, 21 and 22 (a) of the Revenue Acts of 1928 and 1932 * * *.

In the instant case, as in the *Jones* case, the income in question was earned by the personal services of the taxpayer. In both, the motion picture producers required the taxpayers personally to agree to perform the services required, and it may fairly be inferred that in the absence of such personal guaranties they would have insisted on continuing to deal directly with the taxpayers. In each case, the amount for which the taxpayer sold his services was grossly inadequate. It is true that the disparity was not as shocking in the instant situation as in the *Jones* case, yet it may hardly be denied that the present taxpayer would not have sold his services for $750 per week, when he had very good reason to believe he could get about $3,000 per week from American producers, and in fact had a contract to make one picture at that salary, to any one other than his wholly

owned corporation. Finally, in both cases, the effect of the singular arrangements whereby the services were sold for a small fraction of their value, if unchallenged, would have been a corresponding diminution of tax liability.

This case differs from *Jones* v. *Page* in that there the taxpayer sold his services to an individual, his father, whereas in the case at bar taxpayer sold his services to his wholly owned corporation. But we submit that such difference is immaterial. The resort to the corporate form should not afford Laughton the immunity from taxation on his earnings which Jones was held not to have, for the general principle has long been established that the separate juristic entity of a corporation will be disregarded where such action is necessary to prevent the defeat of public or private rights. See *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 442, and authorities there cited. Indeed, the principle that federal income taxes may not be avoided by the utilization of a wholly owned corporation has recently been forcefully affirmed by the Supreme Court. *Griffiths* v. *Helvering,* decided December 18, 1939, not yet officially reported but found in 1940 Prentice-Hall, Vol. 4, par. 62,010; see also *Higgins* v. *Smith,* decided January 8, 1940, not yet officially reported but found in 1940 Prentice-Hall, Vol. 4, par. 62,025.

In *Griffiths* v. *Helvering, supra,* in holding that the employment of a wholly owned corporation as a conduit was ineffective to prevent the taxation of the item of income there involved to the taxpayer, the Supreme Court declared (p. 62,016):

The facts leave little scope for legal explication. Griffiths had a claim for fraud against Lay which, when satisfied, wiped out the loss for which he had received an earlier deduction. Had satisfaction of the claim come to him without any conduit, it would have indisputably been his income. The claim having been recognized by Lay and cast into a form realizable by Griffiths, a lawyer's ingenuity devised a technically elegant arrangement whereby an intricate outward appearance was given to the simple sale from Griffiths to Lay and the passage of money from Lay to Griffiths. That was the crux of the business to Griffiths, and that is the crux of the business to us.

We cannot too often reiterate that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." *Corliss* v. *Bowers,* 281 U. S. 376, 378. And it makes no difference that such "command" may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. Cf. *Gregory* v. *Helvering,* 293 U. S. 465. "A given result at the end of a straight path," this Court said in *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609, 613, "is not made a different result because reached by following a devious path." Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed, * * *. Taxes cannot be escaped "by anticipatory arrangements and contracts however skillfully devised * * * by which the fruits are attrib-

> uted to a different tree from that on which they grew." *Lucas* v. *Earl,* 281 U. S. 111, 115. What Lay gave Griffiths in reality got, and on that he must be taxed.

Here, as in the *Griffiths* case, had the money come to the taxpayer without any conduit, it would indisputably have been his income. Likewise, it would seem that the crux of the business to Laughton was the passage of money from the motion picture producers to him. It is immaterial, for purposes of taxation, that Laughton exercised control over what was paid for his services by the creation of an equitable but controlled interest rather than by direct legal title. It is assuredly true, to paraphrase the language of the Court in the *Griffiths* case, that what the motion picture producers gave Laughton in reality got, and on that he must be taxed.

That result is in no way altered by the Board's finding that Industries, Ltd., was organized for the business purpose of engaging in production on its own account. (R. 29.) Assuming, without conceding, that Industries, Ltd., was organized for a business purpose, all transactions between it and the taxpayer are not thereby invested with an immunity from judicial scrutiny, nor does such purpose obscure the fact that taxpayer in reality received what the producers in fact paid for his services. In the *Griffiths* case, the taxpayer presumably formed his wholly owned corporation solely for the purpose of having it receive the payment from Lay. But while that circumstance may have illustrated vividly the principle of the case, we submit that it can hardly be regarded as essential to the de-

cision. If Griffiths had transferred his right to recover the purchase price of the stock to a wholly owned corporation organized many years before, and for a perfectly legitimate business purpose, rather than to a wholly owned corporation created especially to receive the payment, the decision would assuredly have been the same. Manifestly, a wholly owned corporation organized for a legitimate purpose, even if operated for such purpose, may be availed of, in a particular instance, as a conduit or subsidiary agency just as readily as a corporation created for that very purpose. Hence, it seems inconceivable that the Supreme Court could have intended to limit the principle applied in the *Griffiths* decision to the situation where the wholly owned corporation was created specifically for the purpose of receiving sums otherwise payable to the taxpayer.

Moreover, our position that the money earned by, and paid exclusively for, the personal services of the taxpayer should be taxed to him, notwithstanding the finding that Industries, Ltd., was organized for a business purpose, is fully supported by the decision of the Circuit Court of Appeals for the Fifth Circuit in *Saenger* v. *Commissioner,* 69 F. (2d) 631, a case squarely in point. There, the corporation was admittedly organized for the legitimate business purpose of taking over and operating a large business formerly operated as a partnership, and it did in fact engage in operating such business. The taxpayer agreed to work exclusively for the corporation, and agreed to account to it for any salary or other compensation he might receive from any

other source. Although the corporation was thus the owner of the taxpayer's services, as in the present case, the compensation was held taxable to the taxpayer who earned it, on the authority of *Lucas* v. *Earl,* 281 U. S. 111.

In the instant case, even assuming that Industries, Ltd., was created for the business purpose of engaging in production on its own account, as found by the Board, it is nevertheless apparent that it did not earn any part of the income in question, nor contribute to it in any way, nor did it serve any business function whatever relating to such income. In this connection, it is significant that, although the Board found that Industries, Ltd., was organized for the purpose of engaging in production, the Board made no finding that Industries, Ltd., was organized for, or in fact performed, any business function in connection with the sales of taxpayer's services to the American producers, which were the sole sources of the income in question. Indeed, the record could not possibly be deemed to warrant such a finding, for it is not shown that Industries, Ltd., was in any degree instrumental in obtaining taxpayer's employment by the producers, through its contacts with them, or otherwise. On the contrary, the record affirmatively reveals that taxpayer had been employed by the American producers in five productions in 1932, and one in 1933 at a salary of $2,500 per week, before Industries, Ltd., even came into existence. Moreover, Paramount had actually exercised its option under the contract between it and taxpayer of March 29, 1933, to employ the taxpayer in one production dur-

ing 1934, at $3,000 per week, before Industries, Ltd., was created, and this contract was subsequently cancelled by mutual consent in order that Paramount and Industries, Ltd., might enter into a similar contract for taxpayer's services.

On the facts of record, the conclusion is inescapable that the taxpayer could have obtained precisely the same employment, and at precisely the same terms, had he continued to deal directly with the producers without employing Industries, Ltd., as an intermediary. The producers were interested solely in obtaining taxpayer's personal services, they required him personally to guarantee the performance of such services as a condition to their contracting with Industries, Ltd., and the money they paid to Industries, Ltd., was paid for taxpayer's services as an actor, and for nothing else. In so far as the income involved in this proceeding was concerned, Industries, Ltd., was nothing more than the agency whereby taxpayer retained full control and beneficial interest in the fruits of his personal services without personally receiving them. Whatever may have been the purpose for which Industries, Ltd., was organized, the arrangement whereby taxpayer sold his services to the producers through Industries, Ltd., as an intermediary was manifestly devoid of business purpose, and the income in question should therefore be treated, for purposes of taxation, as though paid directly to the taxpayer. Cf. *Gregory* v. *Helvering,* 293 U. S. 465; *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609.

CONCLUSION

The decision of the Board of Tax Appeals should be reversed.

Respectfully submitted.

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FEBRUARY 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 211. GROSS INCOME.

(a) GENERAL RULE.—In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

* * * * *

(U. S. C., Title 26, Sec. 211.)

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

(a) GROSS INCOME FROM SOURCES IN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

* * * * *

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States;

* * * * *

(U. S. C., Title 26, Sec. 119.)

Treasury Regulations 86, promulgated under the revenue Act of 1934:

ART. 119–4. *Compensation for labor or personal services.*—Gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for services was made, or of the place of payment. If a specific amount is paid for labor or personal services performed in the United States, such amount shall be included in the gross income. If no accurate allocation or segregation of compen-

sation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. Wages received for services rendered inside the territorial limits of the United States are to be regarded as from sources within the United States. * * *

ART. 211–6. *Gross income of nonresident alien individuals.*—In the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States, determined under the provisions of section 119. (See articles 119–1 to 119–14.) * * *

U. S. GOVERNMENT PRINTING OFFICE: 1940